

# EXHIBIT I

**OCLC Online Computer Library Center, Inc.**

NetLibrary  
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Boulder, CO 80301 USA

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1-800-413-4557  
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April 30, 2007

**By Facsimile and Registered Mail**

R. David Hosp  
Goodwin | Procter  
Counselors at Law  
Exchange Place  
Boston, MA 02109

Re: **Reply to Letter Purporting to Terminate eContent Production and Distribution Agreement**

Dear Mr. Hosp,

OCLC Online Computer Library Center, Inc ("OCLC") received on April 23, 2007 the letter (dated April 20, 2007) that you wrote on behalf of Recorded Books, LLC ("Recorded Books"). In this letter, you purported to immediately terminate the eContent Production and Distribution Agreement (the "Agreement") between Recorded Books and NetLibrary, a division of OCLC ("NetLibrary"). If Recorded Books carries through with the actions described in this letter, then Recorded Books will be wrongfully terminating the Agreement and will be responsible for all damages incurred by OCLC and NetLibrary as a result of this wrongful termination.

**A. Recorded Books has not complied with Section 4.(b)(ii) of the Agreement. It has failed to provide 60 days prior written notice before taking steps to terminate its performance of the Agreement.**

In the letter you list several issues that you claim constitute material violations of the Agreement. OCLC does not agree that the issues that you have identified are violations (let alone material violations) of the Agreement, and will respond to these claims below. But OCLC also wants to note that – even if we assume that any of the issues identified by Recorded Books could be viewed as material violations of the Agreement - Recorded Books has failed to comply with Section 4.(b) of the Agreement which sets out a process to be followed if either party materially breaches the Agreement. Section 4.(b)(ii) states:

- (b) Either party (the non-breaching party) may terminate this Agreement at any time after providing the other party with 60 days' prior written notice of the occurrence of any of the following events, unless the other party cures or remedies the event within the 60-day period following receipt of the written notice (...):
  - (ii) A party violates any material provision of this Agreement or otherwise has committed breaches of this Agreement that, in the aggregate, are material. For purposes of this section 4(b)(ii); Sections 3, 5, 7, 9, and 10 of the Agreement; and Exhibits A and B, in their entirety; will be considered "material."

Recorded Books has not satisfied and your letter violates this provision. Recorded Books has not provided 60 days prior written notice to OCLC or NetLibrary of any issue that would constitute a material written breach of the Agreement. Your letter is the first written notice that OCLC or NetLibrary has received suggesting that certain issues, individually or collectively, constitute a material breach of the Agreement.



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**B. The issues identified by Recorded Books in your letter do not - individually or collectively - provide grounds for Recorded Books to claim that NetLibrary has materially breached the Agreement.**

In your letter, you claim that NetLibrary has failed to satisfy its obligations under Section(s) 1(d)(i), (ii), (iii), and (v) of Exhibit B and well as Section 3.(b) of Schedule B-1 to the Agreement. As evidence of these failures, you identify 5 issues:

1. Indexing and access to selected titles;
2. MARC records availability;
3. Patron authentication;
4. File size; and
5. Restrictions on Checkout period duration.

Notwithstanding your statement to the contrary, NetLibrary has satisfied its obligations under Section(s) 1(d) of Exhibit B and 3.(b) of Schedule B-1. Section 1.(a) of Exhibit B covers all of the Services provided by NetLibrary under the Agreement, including the Hosted Services described in Section 1.(d) of the Agreement and the NetLibrary/Recorded Books Co-Branded Site described in Section 3.(b) of Schedule B-1 to the Agreement.

- Section 1.(a) of the Exhibit B to the Agreement provides:
  - (a) Services. netLibrary will use reasonable commercial efforts to perform the Services and assure that the Services are performed in a manner consistent with the specifications contained in this Exhibit and Schedule B-1 - the Technical Specification.
- Section 1.(d) of the Exhibit B to the Agreement provides:
  - (d) Hosted Services. Hosted Service Activities include:
    - (i) The interface and NL System activities reasonably necessary to ensure the site functionality specified in Section 3 and 4 of Schedule B-1.
    - (ii) The network and infrastructure activities reasonably necessary to ensure site maintenance and stability, and to avoid material disruptions in service, including the activities specified in Section 5 of Schedule B-1.
    - (iii) The activities reasonably necessary to ensure the performance of the order processing, submittal, fulfillment, and customer support functions specified in Section 6 of Schedule B-1.
    - (iv) ....
    - (v) A reasonable quantity of customer support to Recipients, with said support including:
      - (1) Responding in a timely fashion to Recipients' Support Queries.
      - (2) Maintaining resources to respond to Recipients' Support Queries.
      - (3) Maintaining documentation of netLibrary's responses to Recipients' Support Queries.
- Section 3.(b) of Schedule B-1 to the Agreement provides:

netLibrary will design and develop a new co-branded site specific to the Recorded Books/netLibrary eAudioBook offering. The site will contain information about the offering, the ability to search/browse the offering, links to a Recipient's affiliated netLibrary site for Checkout and Download, links to the Recorded Books site and the netLibrary site, a login to access a



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Recipient's affiliated netLibrary site, and links to purchase eAudioBook players from Recorded Books.

Read together, these provisions require NetLibrary to use reasonable commercial efforts to perform the Services and to assure that the Services are performed in a manner consistent with Exhibit B and Schedule B-1. NetLibrary has done so. It has used reasonable commercial efforts to perform the Services and to assure that the Services – including the Hosted Services and the Services related to the Co-Branded Site - are performed in a manner consistent with Exhibit B and Schedule B-1

1. NetLibrary has used reasonable commercial efforts to appropriately index Recorded Books titles and to allow authorized Library Patrons access to Recorded Books titles.

Your letter suggests that NetLibrary has breached the Agreement, because NetLibrary has failed to appropriately index and/or allow Recipients access to selected titles with reasonable stability. Indexing and access to selected titles are related, but separate concepts. NetLibrary will separately describe how it has satisfied its obligations in regards to both concepts.

- a. *NetLibrary has used reasonable commercial efforts to appropriately index Recorded Books titles.*

Indexing titles refers to the steps that are taken to permit an authorized Patron to search or browse for titles that fit particular search criteria (e.g. title, author name, subject, or keyword). The Agreement does not contain any obligation that requires NetLibrary to index titles, but NetLibrary understands that offering an indexing function is related to Patron utilization of and Library satisfaction with eAudioBook Subscriptions. Consequently, NetLibrary indexes the titles that Recorded Books submits to it for distribution.

NetLibrary has indexed titles since the eAudioBook Subscription Service was launched in February 2005. During that time, NetLibrary has indexed over 1,920 titles from Recorded Books. The indexing function has worked without incident if a Patron uses title, author name, or key word to search for a title. NetLibrary has experienced a minor issue if a Patron, attempts to use the Subject Index to browse for a title, because the information that was used to populate the subject list that was designed for the eAudioBook Product was not pulled from the same location as the information that was used to populate the subject list for other NetLibrary Products. The issue introduced by this conflict does not preclude Patrons from locating eAudioBooks from Recorded Books, but it means that there may be some difference in the Subject Area where a Patron could browse for an eAudioBooks from Recorded Books are located and the Subject Areas where a Patron could browse for a comparable eBook.

After learning about this minor issue, NetLibrary took steps to correct it. NetLibrary is recoding portions of the co-branded site to improve its functionality in several areas, and plans to release these improvements during the week of May 4, 2007. This was in part attributable to the fact that we were using the subjects as defined by Recorded Books. Improvements to subject area browse functionality are one of the areas addressed by the pending release. To ensure some level of conformity, a NetLibrary Librarian has also been given responsibility for reviewing the Subject Areas assigned by Recorded Books to their titles and, as necessary, modifying these assignments to ensure that Subject Areas are treated consistently within the NetLibrary system. Consequently - as of next week's release and as a result of the additional responsibility that has been given to the NetLibrary Librarian – this issue should be resolved.

- b. *NetLibrary has used reasonable commercial efforts to allow authorized Library Patrons access to Recorded Books titles.*

At the end of January of 2007, NetLibrary began investigating issues related to access to Recorded Books titles in response to an increase in customer service tickets citing access problems with Recorded Books. After investigating this issue, NetLibrary discovered that the increase in customer service tickets



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citing access problems were not attributable to any single cause. Instead these complaints were attributable to a couple of different factors. One factor to which some of these complaints were attributable was the release by Microsoft of a new version of Internet Explorer ("IE7"). Another factor to which some of these complaints were attributable was the expiration of a Microsoft Media license on one of the six servers that NetLibrary used to issue Window Media Player licenses.

NetLibrary's investigation of this issue indicated that a new version of Internet Explorer was creating access issues for some Patrons. IE7 was released in November 2006 and began to enter mainstream use in January of 2007. The Windows Media Player is incorporated in Internet Explorer. It uses an ActiveX control to deliver a license to the Patron checking out a Recorded Books Title. Because the Active X control can be dangerous, IE7 introduced new safeguards to protect users of Internet Explorer from ActiveX controls. These new safeguards accomplished their purpose, but – as part of the upgrade to IE7 – the new safeguards introduced preference settings that allowed a User to determine what level of ActiveX control the User wanted to allow (i.e. ActiveX is not permitted, ActiveX is permitted for digitally signed web sites, ActiveX is permitted for all web sites (digitally signed or otherwise)). The ActiveX settings of some Patrons (i.e. Patrons that selected a restrictive ActiveX preference setting) automatically prevented these Patrons from successfully using IE7 to access Recorded Books titles for a time after IE7 was introduced. Once NetLibrary became aware of this problem, NetLibrary was able to add a computer routine to its system to give Patrons with a restrictive ActiveX preference setting the ability to override that setting for the NetLibrary site. NetLibrary issued this fix in February 2007 and this fix resolved the access issues that were being experienced by Patrons that were attributable to IE7. Recorded Books acknowledged that this issue had been resolved in an email that it sent to NetLibrary on February 22, 2007.

NetLibrary's investigation of this issue indicates that another factor to which some of these complaints were attributable was the expiration of a Microsoft Media license on one of the six servers that NetLibrary used to issue Window Media Player licenses. NetLibrary had a process in place to deal with the expiration of such licenses. Unfortunately, the notice that Microsoft sent to NetLibrary to notify NetLibrary of the expiration of this license was sent to a NetLibrary employee who had just started a two week vacation. Because the license had only expired on one of the six servers that NetLibrary used to issue Window Media Player licenses, the problem appeared to be occurring on a random and sporadic basis. Without the knowledge that the license had expired, NetLibrary spent a considerable amount of time trying to diagnose the problem. NetLibrary finally diagnosed the problem shortly before the employee returned from his vacation. Upon the employee's return, the employee confirmed the problem. NetLibrary resolved the problem by obtaining a new license from Microsoft for the out-of-license server. To reduce the likelihood that this type of problem would ever occur again, NetLibrary increased the number of servers that it uses to issue Window Media Player licenses from six to twelve and added an additional contact to be given advance notice of the expiration of Microsoft Media Licenses.

2. NetLibrary has used reasonable commercial efforts to make MARC records available to Libraries that have purchased Subscriptions to Collections of Recorded Book titles.

Your letter suggests that NetLibrary has breached the Agreement, because NetLibrary has failed to make MARC records available to subscribers and recipients for downloading reliably or with reasonable stability in a timely fashion. This statement is not accurate. NetLibrary has established a process to make MARC records available to Libraries. As described below, this process is reliable, stable, and timely. In addition, NetLibrary has worked with OCLC to pursue and continues to pursue improvements to this process to improve the MARC record experience of Libraries that have purchased Subscriptions to eAudioBook Collections.

A MARC Record is a machine-readable cataloging record. MARC Records are important, because libraries load MARC Records into their computer catalog systems. These systems are a primary means





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by which Library staff and Library Patrons can determine whether a particular title is owned and/or licensed by the library and whether that title is available for check-out by a Patron.

NetLibrary has established a process to make MARC records available to Libraries. Because Recorded Books has agreed to add a certain number of titles each month to the eAudioBook Collections that have been established (e.g. Recorded Books has agreed to add at least 30 titles per month to the Core Collection), Library eAudioBook Subscription Purchases are handled by OCLC's MARC Record Department as a standing order.

The process that has been established to make MARC records available to Libraries works in the following fashion:

- Each month Recorded Books provides and identifies the titles that are to be added to a Collection that month. Recorded Books typically submits these files on a rolling basis.
- NetLibrary converts the titles that are to be added to a Collection for that month into WMA files and then uses Microsoft SDK Software to encrypt the files as eAudioBook Production Files. After the parties QA the eAudioBook Production files, NetLibrary loads them to the applicable collection on the live-site.
- At the time NetLibrary loads the eAudioBook Production files, the files are accessible to the Libraries that have purchased Subscriptions to the applicable collection, but easy location of these files does not occur until the Library receives a Marc Record for the title.
- As NetLibrary loads the eAudioBook Production file to its live site, it sends the information necessary to create the MARC Record to OCLC, and OCLC creates the MARC Record.
- Once per month - usually around the 25<sup>th</sup> of the month - OCLC updates the standing order for each eAudioBook Collection to which titles have been added. This process takes approximately 1 week.
- Once the standing order has been updated, the OCLC System notifies every library with an active Subscription to an eAudioBook Collection to which titles have been added that the MARC Record update for the new titles that have been added to the eAudioBook Collection is complete, and that the Library can now contact OCLC to receive an update to its MARC Record Set for the new MARC Records.

This process takes place on a monthly basis. Since Recorded Books submits titles on a rolling basis, and since the Subject Sets containing MARC Records for the eAudioBook Collections are only updated on a monthly basis, there is a small delay between the date when an eAudioBook is added to the live-site and the date when the Library receives notice that it can update its MARC Records. The previous statement notwithstanding, Libraries that have purchased eAudioBook Collections for which Recorded Books has agreed to add a certain number of titles each month are receiving MARC Records updates containing at least the required number of additional titles. Because of the rolling basis on which titles are submitted, a titles which is submitted shortly after OCLC updates the standing order for the eAudioBook Collection to which the title is added will be one of the first titles for which OCLC creates a MARC Record for the following month.

Your letter identifies several libraries that have complained about NetLibrary's MARC Records process. After previously investigating these complaints, NetLibrary realized that these complaints were not the results of deficiencies with the OCLC MARC Records Process, but rather the failure of the person managing that process to follow it. In response to this discovery, OCLC changed the person managing this process. OCLC has taken additional steps to improve the reliability of MARC Record delivery by changing the subject line and email sender of the MARC Records email to avoid spam filters and libraries "overlooking" the email due to an unclear subject line.

For the record, Recorded Books has a separate agreement with OCLC to supply MARC Records for a Recorded Books video initiative. Recorded Books' video agreement was signed after the eAudioBook



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Agreement. The same division of OCLC that is providing MARC Records for the titles included in the eAudioBook Collections is providing MARC Records for Recorded Books' video initiative. It is difficult to understand why Recorded Books would have signed a second agreement with OCLC to obtain MARC Records for a different content offering, if Recorded Books was dissatisfied with the manner in which OCLC provides MARC Records to Libraries that have subscribed to eAudioBook Collections.

In conclusion, the process described above is reliable, stable, and timely. OCLC uses this process to manage all of the standing orders that it has from libraries for MARC Records to document additions to the libraries collections. Because OCLC uses this process for a large number of libraries and a wide variety of content formats, the process is reliable and stable. As noted above, the process is timely – it provides Libraries that have an active Subscription to an eAudioBook Collection to which titles have been added with a the MARC Record update for the new titles at the start of each month. Finally, NetLibrary has worked with OCLC to pursue and continues to pursue improvements to this process to improve the MARC record experience of Libraries that have purchased Subscriptions to eAudioBook Collections.

3. NetLibrary has used reasonable commercial efforts to provide several processes that Libraries can use to authenticate Patrons for access to Recorded Books titles.

Your letter suggests that NetLibrary has breached the Agreement, because NetLibrary has failed to implement a streamlined authentication process in connection with the NetLibrary system. This statement is not accurate. NetLibrary offers several authentication processes that Libraries can use to authenticate Patrons to the NetLibrary System. These processes include IP Address-based, secure referring URL, encrypted URL API and NetLibrary username and password options that may be used singly or in combination by a library. These authentication processes are reliable, stable, and timely and are standard processes used by companies in the internet industry to manage user authentication. These authentication processes are also the authentication processes that NetLibrary offers to every Library that purchases eContent from NetLibrary. At present, there are over 15,000 libraries using one or more of these authentication processes to access eContent that they have purchased from NetLibrary. These authentication processes satisfy NetLibrary's obligation to provide a system that authenticates Library Patrons for access to eAudioBook Collections.

In addition to providing the authentication processes described above, NetLibrary has explored working with remote authentication software vendors to develop functionality that will integrate a library's Integrated Library Systems (ILS), remote authentication, and access to NetLibrary. NetLibrary has been aware that such an extension in functionality is likely to offer some technical challenges (for NetLibrary, the remote authentication software vendor, and the Library using the ILS System), but - because of requests from Recorded Books and from some Libraries for such integration - NetLibrary has been willing to work to complete such an extension of functionality.

The first vendor with whom NetLibrary has worked to extend such functionality is a vendor called Computer by Design ("CBD"). Its remote authentication software is called CybraryN. As expected, the extension of authentication functionality to the CybraryN system has presented a variety of technical challenges. Because the extension of this functionality requires CBD to perform development to its system, NetLibrary does not have control over the ease or manner in which the extension of authentication functionality is completed. In your letter, you refer to problems experienced by the Iowa City Public Library in connection with the extension of authentication functionality. Iowa City was a Beta Test for the CybraryN system. Everyone involved with this test was aware that it was likely to present a number of issues that needed to be resolved before the extension of authentication functionality was complete. Iowa City did present such issues and the Beta Test did consume a significant quantity of technical resources for the participating parties. But the difficulties experienced with the CybraryN implementation - generally - and with Iowa City - specifically - do not mean that NetLibrary has failed to satisfy its obligation to provide one or more authentication processes that Libraries can use to authenticate Patrons to the NetLibrary System.



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In addition, because NetLibrary is aware of Recorded Books dissatisfaction with the time it has taken CBD to resolve issues arising from the extension of authentication functionality to the CybraryN system, and because NetLibrary has been dissatisfied with aspects of CBD's response, NetLibrary has started working with Useful Utilities - another remote authentication vendor - to integrate authentication functionality to its remote authentication software. A software called the EZproxy system. This effort is likely to face some of the same challenges as the effort with CBD, but it is proceeding, and - to date - Useful Utilities has shown a greater technical ability so NetLibrary is hopeful that the challenges that the effort faces can be addressed in a faster fashion.

4. NetLibrary has used reasonable commercial efforts to provide a system to securely transmit files to Library Patrons. The Agreement contains no provision specifying the size of the files that the NetLibrary System is supposed to transmit.

Your letter suggests that you believe NetLibrary has breached the Agreement, because you object to the size of the files transmitted by the NetLibrary System. But the Agreement does not contain any obligation that requires NetLibrary to restrict the size of the files that the NetLibrary System transmits or to break eAudioBook files into "chunks" for transmittal. Consequently, NetLibrary has not breached the Agreement by failing to do so.

Though NetLibrary is not contractually obligated to restrict the size of the files that the NetLibrary System transmits or to break eAudioBook files into chunks for transmittal, NetLibrary will describe its approach to downloading encrypted eAudioBook files to show that the NetLibrary System deals with the download of encrypted files in a reasonable commercial manner. There are two major ways in which the NetLibrary System could download encrypted eAudioBook files to a Patron's computer or portable listening device. The NetLibrary system could download the entire file or the NetLibrary system could download a portion or chunk of file. The later approach is called chunking.

There are pros and cons to either approach. By downloading the entire file at the time of check-out, the NetLibrary System reduces the burden on the Patron (e.g. to repeatedly access the site in order to obtain additional chunks of an eAudioBook), but increases the burden on the Patron's computer or portable listening device (e.g. downloading eAudioBooks consume a large amount of the storage space on a computer or portable listening device). But by downloading a portion of the file at the time of check-out, a system that chunks increases the burden on the Patron (e.g. to repeatedly access the site in order to obtain additional chunks of an eAudioBook and to manage all of the multiple files that they separately download as a single cohesive unit), but decreases the burden on the Patron's computer or portable listening device (e.g. downloading chunks of eAudioBooks consumes a smaller amount of the storage place on a computer or portable listening device).

At the time the NetLibrary system was created, NetLibrary elected to create a system that did not chunk. One reason NetLibrary selected this approach was that - with continuing improvements in computers and portable listening devices - the burden that downloading an entire eBook to a computer or portable listening device was expected to decrease over time. This has proven to be the case. When NetLibrary and Recorded Books began selling Subscriptions to eAudioBooks in 2005, the capacity of a portable listening device was no more than 512 mb (i.e. at least 4 eAudioBooks). By 2007, the capacity of many portable listening devices had increased to over 30 gb (i.e. at least 20 eAudioBooks). Another reason for this approach was that a system that does not chunk is simpler to create than a system that does. As a result, this decision allowed NetLibrary and Recorded Books to begin selling Subscriptions to eAudioBooks faster than would have otherwise been the case. In short, there were technical, commercial, and customer service reasons that support NetLibrary's decision to create a system that downloaded the entire encrypted eAudioBook file to a Patron's computer or portable listening device.





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5. At the time NetLibrary and Recorded Books launched the Subscription eAudioBook Service in 2005, Recorded Books asked NetLibrary to disable a feature in the NetLibrary System restricting a Checkout period for a recipient on a portable listening device to 21 days. If Recorded Books wants NetLibrary to re-enable this feature, NetLibrary can do so upon a couple of days written notice.

Your letter suggests that NetLibrary has breached the Agreement, because NetLibrary has failed to implement a system that restricts a Checkout period for a recipient on a portable listening device to 21 days. This allegation is false.

Windows Media Player was always the System that the parties had agreed would be used to handle Digital Rights Management for the titles from Recorded Books. Windows Media Player version 9.0 was phasing out as Version 10.0 was being introduced at the Consumer Electronics Show in January 2005. The standard Version of WMP 9.0 did not have the same DRM capabilities as Version 10.0 or as a Windows 9.0 Upgrade called "Janus" ("WMP 9.0+") that contained a feature that could support subscriptions. NetLibrary included such a feature in the NetLibrary Platform that it began testing in December 2004.

But the migration from WMP 9.0 to WMP 10.0 presented a decision point for Recorded Books and NetLibrary. The number of portable devices that could support WMP 10.0 at the start of 2005 was very limited. Consequently, did Recorded Books and NetLibrary want to sell Subscriptions to a service that could be used by very few devices (devices that could support WMP 9.0+ or greater), or did Recorded Books and NetLibrary want to sell Subscriptions to a service that could be used by many more devices (devices that could support WMP 9.0 or greater). Because this feature significantly restricted the number of portable Windows Media Player Compatible devices that could qualify to play Recorded Books titles, Recorded Books asked NetLibrary to disable this feature. Recorded Books reasoned that

- there was little likelihood of long term retention of the content on a Patron's portable device, because the unencrypted content could not be transferred from the device to any other device (WMP 9.0 possessed enough DRM capacity to prevent such transfers) and because any Patron with version 9.0 would want to listen to additional titles and thus would need to delete files from his player in order to free up space.
- Portable devices that supported WMP 10.0 would soon be released (many were being demonstrated at the CES in January 2005) so the issue would be greatly diminished.

At Recorded Book's direction, NetLibrary disabled the feature that prevented versions of WMP 9.0 from accessing Subscription Content. Recorded Books never asked NetLibrary to re-enable this feature. If Recorded Books wants NetLibrary to re-enable this feature, Recorded Books merely needs to give NetLibrary notice of this desire and NetLibrary will do so promptly.

**C. Section 1.(a) of Exhibit C does not give Recorded Books the right to immediately terminate the Agreement if NetLibrary begins to sell eAudioBooks from other eAudioBook Publishers.**

In your letter you further claim that Recorded Books has the right terminate the Agreement in accordance with Section 1(a) of Exhibit C, "as its right" in light of NetLibrary's decision to forego the exclusivity provisions of that exhibit. Section 1.(a) of Exhibit C does not give Recorded Books such a right of immediate termination. Section 1.(a) of Exhibit C states:

- (a) The Subscription sales model described in this Agreement is the exclusive means by which netLibrary will market, distribute, and sell to Recipients digital electronic versions of eAudioBooks that can be downloaded via the Internet. The Subscription sales model described in this Agreement is the exclusive means by which Recorded Books will market, distribute, and sell to Recipients digital electronic versions of eAudioBooks that can be downloaded via the Internet. netLibrary and Recorded Books will allow other content providers to contribute content and to



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participate in this Subscription sales model on equivalent terms. If, without Recorded Books' consent, netLibrary signs an Agreement to allow another content provider to contribute eAudioBook content and to participate in a Subscription sales model to which Recorded Books is not a party; then, subject to Section 1.(e) of Exhibit B, Recorded Books may give netLibrary written notice terminating this Agreement immediately.

Section 1.(a) of Exhibit C only gives Recorded Books the right to immediately terminate this Agreement if "NetLibrary signs an Agreement to allow another content provider to contribute eAudioBook content and to participate in a Subscription sales model to which Recorded Books is not a party." NetLibrary has not done so. NetLibrary has not signed an Agreement to allow another content provider to contribute eAudioBook content and to participate in a Subscription sales model to which Recorded Books is not a party.

NetLibrary acknowledges that Recorded Books' wanted to include an exclusivity provision in the Agreement. As an early entrant to the Digital eAudioBooks Market, Recorded Books was interested in ensuring that it received special treatment under any business model pursued by NetLibrary. But – as a division of a non-profit corporation – NetLibrary could not agree to such a request. Consequently, NetLibrary and Recorded Books revised section 1.(a) of the Agreement to accommodate their mutual concerns. NetLibrary was willing – in good faith - to restrict its ability to pursue new business models (see the 1<sup>st</sup> sentence of Section 1.(a) of Exhibit C), if Recorded Books would – in good faith – allow other content providers to participate in the Subscription sales model on equivalent terms (see the 3<sup>rd</sup> sentence of Section 1.(a) of Exhibit C). But – after the Agreement was signed - Recorded Books showed little interest or willingness to comply with its obligation under the 3<sup>rd</sup> sentence of Section 1.(a) of Exhibit C. NetLibrary did not discuss alternate business models with other eAudioBook Content Providers until after Recorded Books had repeatedly ignored NetLibrary's attempts to discuss the addition of other eAudioBook content providers to the Subscription Sales Model on equivalent terms. As part of this effort, NetLibrary spoke repeatedly with Recorded Books about the alternate business model activities it was undertaking, repeatedly invited Recorded Books to participate in these activities, and repeatedly invited Recorded Books to suggest alternate business models in which it would permit other eAudioBook Content Providers to participate. Recorded Books never did. Consequently, NetLibrary does not agree that it has violated Section 1.(a) of Exhibit C. NetLibrary believes that Recorded Books is the party that violated Section 1.(a) of Exhibit C. Any actions that NetLibrary has taken to pursue alternate business models were precipitated and justified by Recorded Books failure to comply with its obligation to allow other content providers to contribute content and to participate in this Subscription sales model on equivalent terms.

**D. Notwithstanding suggestions by Recorded Books to the contrary, the eAudioBook Subscription Service has been a great success for Libraries, NetLibrary and Recorded Books.**

By most measures, the eAudioBook Subscription Service that Recorded Books and NetLibrary launched in February of 2005 has been a great success. As the first electronic offering of downloadable Audio Books to Libraries, the eAudioBook Subscription Service has been a great success. Libraries' embrace of the eAudioBook Subscription Service is shown by several statistics.



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Statistic	As of 4/30/07
1. The total number of Libraries that have purchased eAudioBook Subscriptions	<ul style="list-style-type: none"> <li>• Since February 1, 2005, over 1700 Libraries have purchased eAudioBook Subscriptions.</li> </ul>
2. The growth in the number of Libraries that have purchased eAudioBook Subscriptions	<ul style="list-style-type: none"> <li>• The number of libraries purchasing eAudioBook Subscriptions during 2005 increased by over one hundred and twenty three percent (123%).</li> <li>• The number of libraries purchasing eAudioBook Subscriptions during 2006 increased by over two hundred and thirty-one percent (231%) over 2005.</li> </ul>
3. The total value of eAudioBook Subscriptions sold to Libraries	<ul style="list-style-type: none"> <li>• The total value of eAudioBook Subscriptions sold to Libraries is over \$13.7 million USD</li> </ul>
4. The growth in the value of eAudioBook Subscriptions sold to Libraries	<ul style="list-style-type: none"> <li>• During 2005, the total value of eAudioBook Subscriptions sold to Libraries was over \$3.6 million USD</li> <li>• During 2006, the total value of eAudioBook Subscriptions sold to Libraries was over \$6.9 million USD</li> <li>• During the first four months of 2007, the total value of eAudioBook Subscriptions sold to Libraries was over \$3 million USD.</li> </ul>
5. The percentage of Libraries that have renewed eAudioBook Subscriptions.	<ul style="list-style-type: none"> <li>• The percentage of Libraries that renewed eAudioBook Subscriptions between February 1, 2006 and February 1, 2007 was eighty-eight percent (88%)</li> </ul>

In addition, OCLC NL provided Recorded Books with expedited access to the Library Market. With this expedited access, two years before most other Audio Book Providers, Recorded Books realized several significant advantages, including the ability to test the Subscription business model, the ability to test a variety of eAudioBook Collections, the opportunity to offer these eAudioBook Collections to thousands of Libraries, and the opportunity to get thousands of libraries used to purchasing Subscriptions to Recorded Books eAudioBooks. The statistics identified above offer testament to the success of the eAudioBook Subscription Service, and – as evidenced by the fact that eAudioBook Subscription Revenue has far exceeded the Agreement renewal triggers included in Section(s) 4.(a) and 4.(b) of the Agreement – substantially exceeds the economic expectations of either Recorded Books or NetLibrary.

The Recorded Books Sales Team has made a significant contribution to the success of the eAudioBook Subscription Service. But so have NetLibrary and OCLC. NetLibrary has made significant investments and developed processes in many areas contributing to the success of the eAudioBook Subscription Service. These areas include: the development of the NetLibrary System that is used to provide Services to Libraries that have purchased eAudioBook Subscriptions, the conversion of eAudioBook files for download to the NetLibrary System, the processing of Orders for eAudioBook Subscriptions, and the provision of Customer Support. OCLC has also made significant investments in areas contributing to the success of the eAudioBook Subscription Service. OCLC's efforts include the development of an effective use program for eAudioBooks, substantial investments in promotional and marketing materials, and – as previously noted – modifications to the OCLC MARC Records process. The success of the eAudioBook Subscription Product identified in this Section is a product of the collective efforts of all parties to the Agreement (Recorded Books, NetLibrary, and OCLC).



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Consequently, suggestions by Recorded Books that Library complaints and Patron dissatisfaction with the NetLibrary system have caused significant harm to Recorded Books is misplaced. The eAudioBook Subscription Service has been so successful that this success may be one reason Recorded Books is trying to find justifications to terminate the Agreement before it would otherwise expire (i.e. on September 9, 2010).

**E. Though Recorded Books has complained about aspects of the eAudioBook Service Offered by NetLibrary, Recorded Books has refused repeated requests from NetLibrary to participate in a discussion to discuss our business relationship.**

No business relationship is perfect. Recorded Books has – via your letter – indicated its dissatisfaction with certain aspects of the existing business relationship and certain aspects of the NetLibrary System. NetLibrary is not satisfied with certain aspects of the existing business relationship and with certain aspects of the way in which Recorded Books has sold eAudioBook Subscriptions. Unfortunately, since June of 2006, communications between our organizations have been strained. There have been communications between the Recorded Books sales organization and the NetLibrary sales support organization. But discussion of technical, marketing, promotional, and strategic issues has been limited.

Section 1.(d) of Exhibit C states:

- (a) netLibrary and Recorded Books will meet periodically, but no less than once every 6 months, to review both parties' performance under this Agreement. Such meetings will take place via telephone or other means mutually agreed upon by the parties. Each party will bear its own costs incurred in connection with such meetings. The topics that may be discussed at these meetings include, but are not limited to: sales, technical, marketing, and promotional activities; the composition of the Bundled Collection; the List Price(s) of a Subscription to the Bundled Collection; and expansion of the scope of this Agreement to cover other types of digital content (e.g. music or video)

Though NetLibrary has repeatedly requested that the parties hold such a meeting (e.g. in communications from Rick Schwieterman, CFO of OCLC, to Brian Downing, Vice President of Recorded Books, in March 2007 and communications between Jay Jordan, CEO of OCLC, to Brian Downing, Vice President of Recorded Books, in March 2007); Recorded Books has – in violation of Section 1.(d) of Exhibit C - rejected NetLibrary's requests.

NetLibrary further notes that Brian Downing sent Rick Schwieterman a task list of issues with which Recorded Books had concerns on February 22, 2007. Recorded Books did not characterize any of the issues on this list as breaches of the Agreement, but Recorded Books did characterize these issues as serious matters that needed attention from NetLibrary. Some of the issues on Recorded Books list are items that were included in your letter and to which NetLibrary has now responded. That being said, it is difficult for NetLibrary to know if it has correctly understood the issues raised by Recorded Books if Recorded Books refuses to communicate about such issues.

**F. Conclusion**

NetLibrary has not breached its Agreement with Recorded Books. Even if NetLibrary has breached its Agreement with Recorded Books, Recorded Books has not provided NetLibrary with the contractually required notice and cure period in order for Recorded Books to terminate the Agreement. Consequently, Recorded Books does not at present possess the right to unilaterally and immediately terminate its relationship with NetLibrary or NetLibrary's right to market, sell, and distribute eAudioBook Subscriptions. If – in spite of the detail provided in this response - Recorded Books continues with its current course of action and wrongfully terminates the Agreement, then OCLC and NetLibrary will hold Recorded Books responsible for all the damages that they incur as a result of this wrongful termination. NetLibrary values



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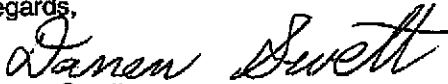
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its business relationship with Recorded Books and has repeatedly offered to participate in a meeting with Recorded Books to discuss the future of this relationship. Until the parties settle the future of this relationship, NetLibrary will comply with the terms of its Agreement, and will continue to accept orders from Libraries for the purchase of eAudioBook Subscriptions.

Please contact me if you would like to discuss this response.

Regards,



Darren Swett  
General Counsel

NetLibrary, a division of OCLC Online Computer Library Center, Inc.

Cc: Jay Jordan, President and CEO, OCLC Online Computer Library Center, Inc.  
Rick Schwleterman, Vice President and CFO, OCLC Online Computer Library Center, Inc.  
Jim Houfek, General Counsel and Secretary, OCLC Online Computer Library Center, Inc.  
David Berset, President of Recorded Books, a Division of Hights Cross Communications Company  
Brian Downing, Vice President of Recorded Books, a Division of Hights Cross Communications Company  
Neil Tress, CFO of Recorded Books, a Division of Hights Cross Communications Company

